

Central Intelligence Agency



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CHINA: TEXTILE NEGOTIATIONS AND THREATS OF RETALIATION [REDACTED]

During prolonged negotiations over the level of China's textile and apparel exports to the United States, the Chinese have threatened to retaliate by reducing imports of US products. With a final negotiating session imminent and the United States preparing to impose unilateral controls, a leading official of China's trade ministry said on 2 January that China "cannot but respond strongly in order to safeguard our own interests."

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The Chinese have openly expressed their deep concern that growing protectionist sentiments in the West may hamper their modernization effort by preventing them from earning the foreign exchange ultimately required to pay for their large capital import needs. Textiles and apparel, which currently account for one-fourth of China's total foreign exchange earnings, are a key to the success of their export drive. Articles in the Chinese press and in economic journals indicate that Beijing believes it can develop a strong competitive edge over other LDCs in textiles, and hopes to capture a much larger share of the US market. In order to achieve that long-term goal, Beijing probably is willing to switch purchases of some commodities to alternative suppliers in order to pressure Washington into allowing China greater access to US markets.

The additional cost China would incur from buying elsewhere would depend, of course, on the particular commodity. The most frequently cited targets for reprisals are goods directly related to the textile industry -- cotton and synthetic fibers. China

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This memorandum was prepared by [REDACTED] the Office of East Asian Analysis in response to questions from the United States Trade Representative. Questions and comments are welcome and should be directed to Chief, Development Issues Branch, China Division [REDACTED]

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has also threatened to cut off purchases of US agricultural commodities as a whole, stressing corn and lumber. In November 1981, the then-Ministry of Foreign Trade listed a broad range of US goods imported by China, including food products, chemicals, and semifinished manufactures, that might be purchased elsewhere as a result of US textile quotas.

Threats of retaliation are not a new negotiating tactic for the Chinese. In 1976, for example, Beijing implied that it would direct more of its purchases to Japan and the EC if Washington did not move forward with the normalization of diplomatic relations on Beijing's terms. During this period Beijing indeed shifted a few purchases to countries where prices were marginally higher than those prevailing in the US--an indication that these threats were not mere bluffs. For most commodities however, the Chinese had other motives--aside from retaliation--for switching suppliers and hence their threats were somewhat disingenuous.

In the current textile negotiations we believe that the Chinese are still posturing and that they have not yet decided what course of action to take. Although they have pointed to their recent cuts in purchases of US textile fibers as an indicator of their seriousness, fiber imports have been reduced worldwide. So far Beijing appears to be merely making a "negotiating virtue" out of economic necessity.

Recent US-China Trade Trends

Through the third quarter of 1982, China's imports of US products were down 11 percent compared with the same period in 1981. Imports from all countries were down 12 percent, so the United States has not been singled out. With China's world-wide trade surplus and foreign exchange reserves at all-time highs, claims that purchases of US products depend on the foreign exchange earned from sales of Chinese textiles to the US are exaggerated.

China has already cut imports of textile fibers and yarn--both cotton and synthetics--primarily because of large domestic inventories. Purchases of pulp and paper goods also have dropped as the Chinese nearly tripled imports of logs to supply both construction and wood product industries.

On the positive side, aside from the jump in log imports, purchases of plastics--particularly polyethylene and polypropylene--have increased rapidly, followed closely by unprocessed hides and leather. Purchases of fertilizers and construction and factory machinery have also shown strong growth. China has continued to buy US grain, with corn purchases up sharply because of low US prices.

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What We Can Expect

It is unlikely that Chinese purchases of textile fibers and yarn will resume at previous levels. China has had three successive record cotton crops and will continue to cut back on imports unless a crop fails. Increased domestic capacity has reduced the need for imports of most synthetic fibers.

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China will probably continue buying US grain, fertilizer, and machinery. There are other sources for grain--especially wheat--but we believe China would not jeopardize long-term, commercial grain trading relationships by turning to suppliers that are higher priced and less reliable. Long-term grain agreements are not held inviolable by the Chinese, however; for instance, a grain agreement with Argentina called for a minimum purchase of 1 million metric tons in 1981, but China bought only 100,000 tons. Even without violating the US-China grain agreement, the Chinese could apply pressure by reducing purchases by up to 2 million tons.

The US is also the best source for certain compound fertilizers and factory equipment that China needs to improve agriculture and modernize industry. For instance, the only comparable large-scale source for highly-desired diammonium phosphate is South Korea, and importing from that country carries a political price China is unlikely to pay.

Aside from continued reduced levels of textile fiber imports, logs and plastics are the most likely products to suffer import cuts in 1983. Until recently, the United States has been the only available source of logs in the volume China needs, and it was unlikely that China would stop buying US timber and thereby disrupt its construction and processing industries. However, the Chinese could get logs immediately from the Soviet Union--historically its largest supplier. At present, the Soviets have excess capacity due to a cutback in purchases by Japan. If Sino-Soviet relations were to improve, the Soviets probably could recover their past share of the market. In addition, the Chinese may already be buying from Canada, according to unconfirmed reports.

China needs imported plastics to support development of light industry. New capacity could replace some imports in 1983, and Western Europe and Japan, whose petrochemical industries are suffering badly from the recession, would welcome additional sales. Plastics accounted for only 5 percent of US sales to China in 1981, and 7.6 percent through September 1982. A total cutoff of purchases from the United States would cost US producers up to \$250 million.

Potential new Chinese purchases may also be affected. At a time when most less developed countries are cutting imports in the wake of serious financial problems, Beijing is holding more than \$9 billion in foreign exchange reserves. Preliminary

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official statements indicate that China is gearing up for an increase in imports of perhaps as much as 25 percent in 1983. If the United States maintains its market share it stands to gain an additional \$1 billion in sales. Although low prices and optimum financing arrangements will be the key to securing new contracts in a competitive environment, Chinese retaliation for US textile quotas could become an impediment for US firms.

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China's Imports of Selected US Products Through Third Quarter, 1982
(Million US Dollars)

Product	1981 Jan-Sept	1982 Jan-Sept	Percent Change
Grains, cereals	984.9	1042.2	+6
Hides, leather	41.0	65.2	+59
Wood, logs	63.1	178.4	+183
Plastics	110.3	182.7	+66
Fertilizers	87.0	101.0	+16
Non-electric machinery	95.8	112.6	+18
Textile fibers	592.3	252.1	-57
Textile yarns	226.3	122.1	-46
Pulp	61.3	14.2	-77
Paper, paper products	58.4	26.3	-55
Total	2680.5	2393.6	-11

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